London Update

UK Financial Services Regulatory Developments

Katten
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UK DEVELOPMENTS

FSA Fines Former CEO for Market Abuse

On 6 July, the Financial Services Authority (FSA) announced that it had fined Henry Cameron, CEO of Sibir, a former Alternative Investment Market (AIM)-quoted energy company, £350,000 for making misleading announcements to the market regarding payments from Sibir to its major shareholder Chalva Tchigirinski. The penalty reflected a Stage 1 (30%) discount under the FSA's settlement discount scheme.

Mr. Cameron was responsible for Sibir making two separate market announcements in December 2008 and February 2009, stating that Sibir had paid a total of $115.4 million (approximately £74 million) to Mr. Tchigirinski. The correct amount was more than $300 million (approximately £190 million). This created a false market in Sibir's shares by giving a misleading impression as to the nature and value of Sibir's assets and the risks the company faced. When the true position became clear, Sibir's shares were suspended from trading on AIM and its quotation was subsequently cancelled. Cameron was suspended from Sibir in February 2009 and dismissed in April 2009.

Margaret Cole, Director of Enforcement and Financial Crime at the FSA, said, "As the most senior executive director at Sibir, Cameron should have known these announcements were misleading and the serious impact they were likely to have on the market. The consequences of his market abuse were so serious that it led to the suspension of trading in Sibir's shares on AIM. Our fine reflects the gravity of his irresponsible actions and shows that we are serious about taking action against directors of publicly traded companies who commit market abuse. It is not acceptable for directors to take action which is in the interests of some shareholders while keeping others in the dark."

Read more.

Takeover Panel Bans Three

On 14 July, the Takeover Panel announced the decision of the Takeover Appeal Board to uphold the decision of the Hearing Committee of the Takeover Panel to ban Daniel Posen, Brian Myerson and Brian Padgett for three years from all dealings with any person registered with the FSA.

The Appeal Board upheld the finding that in March 2009, 6.7 million shares of Principle Capital Investment Trust Plc (PCIT) were acquired by Messrs. Posen, Myerson and Padgett acting jointly as a "concert party". In a deliberate attempt to circumvent the requirement under Rule 9 of the City Code on Takeovers and Mergers to make an offer to shareholders of PCIT generally, they purported to be acting separately rather than as a concert party. When the Takeover Panel investigated the transaction, in breach of their obligations to assist the Panel, Messrs. Posen, Myerson and Padgett attempted to conceal the circumstances relating to their acquisition of PCIT shares and to present a false picture.

This type of ban, known as "cold shouldering", is the first imposed by the Takeover Panel since 1992. It is effectively a three-year ban on any UK financial services or mergers and acquisition activity for the three men concerned.

Read more.

HMRC Anti-Money Laundering Guidance for Money Service Businesses

On 16 July, HM Revenue and Customs (HMRC) published a revised version of its anti-money laundering guidance for money services businesses which it supervises. The revised guidance addresses issues arising under the Counter-Terrorism Act 2008. HMRC also stated that guidance for e-money issuers will be incorporated into a further revised version of the guidance which will be issued shortly.

Read more.

FSA Fines Father and Son for Market Abuse

On 19 July, the FSA announced that it had fined Jeremy Burley £144,200 and his father, Jeffery Burley, £35,000 for market abuse in relation to the shares of Tower Resources plc, an oil and gas exploration company, in June 2009.

Jeremy Burley, a British citizen resident in Uganda, was at the relevant time the Managing Director of BMS Minerals, a Ugandan company which provided vehicles and equipment to oil and gas exploration companies in Uganda, including Tower Resources. Jeffery Burley opened a share trading account in the UK, which he used to trade shares on behalf of his son.

On about 11 June 2009, Jeremy Burley learned that drilling at Tower's first Ugandan oil well was unlikely to produce oil and that the exploration of a second well was unlikely to proceed.

Before Tower announced this negative news on 15 June 2009, Jeremy Burley passed this information on to his father and another person, instructing his father to sell his entire holding of 790,000 shares in Tower. Jeremy Burley advised his father to try and avoid attention by selling the shares in multiple small lots. By selling his 790,000 shareholding ahead of the announcement, Jeffery Burley avoided a loss of £21,700.

Margaret Cole, FSA's Director of Enforcement and Financial Crime, said: "The FSA views the conduct of Jeremy and Jeffery Burley as particularly serious. Jeremy Burley acquired inside information through the course of his employment in Uganda, passed that information to others and used it for his own personal benefit. The actions of father and son were deliberate and premeditated and they took steps to disguise their insider dealing."

Both Jeremy and Jeffery Burley agreed to settle this case at an early stage and therefore qualified for a 30% discount. Had the fines not been discounted, Jeremy Burley would have been fined £175,000 in addition to the disgorgement of £21,700 and Jeffery Burley would have been fined £50,000.

Read more.

FSA Secures £3.7 Million Compensation for Victims of Upton & Co. Unauthorised Collective Investment Scheme

On 20 July, the FSA announced that it had secured £3,717,000 in compensation for investors in an unauthorised collective investment scheme operated by Upton & Co. Accountants Limited (Upton), owned and controlled by Darren Upton, a member of the Association of Chartered Certified Accountants.

The Wakefield-based firm, which was not authorised by the FSA to do so, operated a collective investment scheme known as the "Currency Plan" promising investors high rates of return allegedly derived from foreign exchange investments. However, limited foreign exchange trading occurred and very little was ever returned in cash.

In February 2009 the FSA commenced an investigation into Upton and promptly realised that the firm was carrying out unauthorised business. A month later, the FSA secured a High Court injunction to stop the activity and freeze the firm's assets.

The July 2010 High Court ruling approved the immediate distribution of £3,717,000 to investors on a pro rata basis, and Upton has agreed to make further monthly payments of £10,000, which will be used for further pro rata distributions to investors.

Margaret Cole, FSA's Director of Enforcement and Financial Crime, said: "This is a fantastic result. It is so rare for victims of unauthorised businesses to get any money back because normally the money is misappropriated and victims of unauthorised firms are not protected by the Financial Services Compensation Scheme."

Read more.

Government Consults on Financial Services Reform

On 26 July, HM Treasury launched a consultation ("A new approach to financial regulation: judgment, focus and stability") on the reform of the financial services regulatory regime announced by the Chancellor of the Exchequer in June, as reported in the July edition of *London Update*.

The Government considers that reforms must focus on three key areas: (1) macro-prudential regulation; (2) improved prudential regulation of individual firms; and (3) improved consumer protection and markets regulation.

The consultation document contains detailed reform proposals, and the Government also proposes to establish three new regulatory bodies:

1. the Financial Policy Committee (FPC), designed to give the Bank of England increased power over macro-prudential regulation and likely to be established on an interim basis before the end of 2010;

2. the Prudential Regulation Authority (PRA), under the control of the Bank of England/FPC, to be responsible for supervising banks, other deposit-takers, broker-dealers, investment banks, insurers and certain other financial institutions. The PRA will be headed by a Deputy Governor of the Bank of England, initially the current FSA Chief Executive, Hector Sants; and

3. the Consumer Protection and Markets Authority (CPMA), which will regulate conduct of business.

The introduction of macro-prudential regulation is designed to correct a perceived prior lack of regulatory focus on systemic risk and the financial system as a whole.

The FPC is at the heart of the new system. Six of its eleven members will be from the Bank of England, and the Treasury will have a non-voting representative and a watching brief on behalf of the Government. The CPMA Chief Executive will also sit on the FPC. Along with the close cooperation between the FPC and the PRA, this is intended to ensure that potential systemic risks arising from activities monitored by the CPMA or the PRA will be taken into account in FPC decisions.

The consultation will close on 18 October.

Read more.

FSA Bans Three Stockbroker Directors

On 28 July, the FSA banned Stephen Coles, Luke Ryan and Michael Yamoah, the three directors of Simply Trading Group Limited (STG) (a small private client advisory stockbroker) from holding any financial services senior management positions.

Coles, Ryan and Yamoah shared responsibility for the management of STG, which specialised in telephone sales of securities traded on the London Stock Exchange and higher risk securities traded on the AIM and PLUS markets, through two "appointed representatives."

The FSA investigation found that Messrs. Coles, Ryan and Yamoah:

1. relied too heavily on an external compliance consultant for advice on how to run the compliance aspects of STG's business;

2. failed to make sure that STG met regulatory requirements, including capital resources and systems and controls requirements; and

3. failed to monitor adequately their two appointed representatives, creating a serious risk that customers would receive unsuitable investment advice. This included a failure to ensure that call monitoring equipment was in place at one of the appointed representatives.

As a result of the ban imposed on its three directors, STG no longer met FSA authorisation requirements and its FSA permission to conduct investment business was cancelled.

Read more.

Supreme Court Confirms Court of Appeal Ruling on FSA Enforcement Capabilities

On 28 July, the Supreme Court upheld the English Court of Appeal's judgment that the power of the FSA to prosecute criminal offenses was not limited to the offenses specified in sections 401 and 402 of the Financial Services and Markets Act 2000 (see the November 2009 edition of *London Update*). In particular, the Supreme Court confirmed that the FSA has the power to prosecute money laundering and other offenses within the ambit of the FSA's statutory objectives.

To read the Supreme Court judgment, click here.

FSA Announces Changes to its Remuneration Code

On 29 July, the FSA announced plans to update its Remuneration Code to take account of new remuneration rules required under the EU Capital Requirements Directive (CRD3).

The FSA's current Code requires that firms apply "remuneration policies, practices and procedures that are consistent with and promote effective risk management." Although it is broadly consistent with CRD3 provisions, the FSA is required to make some changes to ensure full alignment.

The current Code applies only to the largest UK banks, building societies and broker dealers. However, the CRD3 rules will bring over 2,500 firms within the scope of the Code. This will include all banks and building societies, asset managers (including hedge fund managers), Undertakings for Collective Investments in Transferable Securities (UCITS) investment firms and stockbrokers, as well as firms that engage in corporate finance, venture capital and the provision of financial advice.

The FSA does not intend its final rules to be more stringent than the CRD3 requirements unless UK legislation to that effect is passed.

Read more.

FSA Cracks Down on Sales of Private Funds

In July, the FSA publicized widespread failings in the marketing of "unregulated collective investment schemes"—a category of fund products which includes almost all private funds including all hedge funds other than those established within the EU UCITS Directive framework. This does not mean that such funds cannot be sold in or from the UK, but it emphasizes the need for great attention to the details of the relevant regulations before, and while, doing so.

The FSA announced that it had just completed a project examining the promotion and sale of unregulated collective investment schemes to retail customers by financial advisers. The FSA stated that it had uncovered widespread failings by financial advisor firms in understanding the regulatory requirements for the promotion of these funds, a lack of understanding of the market within which these schemes operated and of the risks of investment in these funds. This has resulted in firms marketing and selling these funds to customers who were not eligible to purchase them. The FSA is bringing enforcement proceedings against a number of regulated firms.

This topic will shortly be the subject of a Katten *Client Advisory*.

Read more.

EU DEVELOPMENTS

European Banking Bonus Restrictions to Be Introduced

On 7 July, the European Parliament approved, by a large majority, measures which will significantly restrict bonus payments by banks. They were passed in the context of amendments to the EU Capital Requirements Directive for banks and investment firms (proposal for a directive of the European Parliament and of the European Council amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies).

The proportion of bonuses payable in cash may not exceed 30% of the total bonus amount (20% for large bonuses). Between 40% to 60% of all bonuses must be deferred and can be clawed back if performance in subsequent years is not adequate. 50% of the total bonus would be paid as "contingent capital"—funds which can be called upon by the bank for use as capital if required. Bonuses must also be "capped to salary." Each bank will have to establish limits on bonuses related to salaries, based on EU guidelines. There will be more stringent rules applicable to part-nationalised banks.

The detailed provisions implementing the above guidelines have not yet been published.

Separate draft remuneration rules for fund managers falling within the ambit of the draft Alternative Investment Funds Directive are being considered in the ongoing trialogue process between the European Commission, Council and the Parliament, under which the competing drafts produced by the European Council and the Parliament are being harmonised. An agreed text is expected to be passed to the Parliament for a plenary vote in September or October of this year.

Read more.

CESR Publishes Consultation Paper on Standardisation and Exchange Trading of OTC Derivatives

On 19 July, CESR published a consultation paper (CESR/10-610) on the standardisation and exchange trading of over-the-counter (OTC) derivatives, seeking views on a number of issues, including:

- **Exchange trading**. CESR supports providing incentives to promote the use of organised trading venues for derivatives and is consulting on whether it would be desirable to make such usage mandatory.
- **Standardisation**. CESR considers that greater standardisation of OTC derivatives contracts could deliver efficiency benefits, although firms should be able to retain the flexibility to customise aspects of an OTC derivatives contract such as standard valuation, payment structures and payment dates. The consultation seeks views on how standardisation can be increased. CESR is also considering recommending that the European Commission take regulatory action to make the use of electronic confirmation systems mandatory for European trading of OTC derivatives.

The consultation period ends on 16 August. CESR intends to send technical advice to the Commission, based on responses to the consultation, in September 2010.

Read more.

CESR Publishes Consultation Paper on Transaction Reporting

On 19 July, CESR published consultation paper CESR/10-809 setting out proposals for transaction reporting for over-the-counter (OTC) derivatives and the extension of the scope of transaction reporting obligations.

CESR's OTC derivatives transaction reporting proposal is based on the assumption that all persons not exempted from European Market Infrastructure Legislation (EMIL) (including Markets in Financial Instruments Directive (MiFID) authorised firms) would have to report their OTC derivatives transactions to trade repositories (TRs) after these will have been established and registered under EMIL.

However, CESR proposes that investment firms would retain the possibility of complying with their transaction reporting obligations with respect to OTC derivatives under MiFID provisions.

Investment firms choosing to report their transactions to a TR, supporting MiFID standards, would be exempted from direct reporting as long as they communicate their decision to the competent authority. The MiFID regime would therefore apply to reporting obligations, but these could be dealt with by TRs for the account of investment firms in order to avoid duplication. TRs would be recognised as a valid third-party reporting mechanism under Article 25(5) of MiFID.

Until EMIL has been finalised and implemented, OTC derivatives transactions would be reported under MiFID rules, where applicable.

CESR is also considering whether to propose to the European Commission to extend, through a change in Article 25 of MiFID, the scope of transaction reporting obligations to financial instruments that are admitted to trading only on MTFs and to OTC derivatives.

The comment period ends on 16 August.

Read more.

CESR Consults on the UCITS IV Key Investor Information Document

On 20 July, the Committee of European Securities Regulators (CESR) published the following four consultation papers on the key investor information document (KII) under the Undertakings for Collective Investments in Transferable Securities (UCITS) Directive (2009/65/EC) (known as "UCITS IV").

- A consultation on level 3 guidance on the selection and presentation of performance scenarios in the KII for structured UCITS (that is, certain types of capital-protected and guaranteed UCITS). Read more.
- A consultation on guidelines for the transition from the simplified prospectus to the KII. Read more.
- A consultation on a guide to clear language and the layout for the KII. Read more.
- A consultation on a template for the KII. Read more.

CESR Proposes Changes to MiFID Regime

On 29 July, CESR published advice to the European Commission after conducting a reviewing of and consultation on MiFID. If adopted, the reforms proposed by CESR would significantly change the EU regulatory landscape.

The advice covers the following areas:

1. technical advice on equity markets—improving the pre-trade transparency regime for exchanges and Multilateral Trading Facilities (MTFs); reviewing the definition of and obligations for systematic internalisers; enhancing the quality of post-trade transparency information; extending the transparency obligations to equity-like instruments; improving the regulatory framework for consolidation and addressing cost of market data; establishing a new regulatory regime for broker crossing systems; and tackling market micro-structural issues;

2. non-equity markets transparency—re-defining the scope of the post-trade transparency regime for bonds; establishing a phased approach for the introduction of a post-trade transparency regime for structured finance products; extending the scope to clearing eligible sovereign Credit Default Swaps; enhancing the post-trade transparency of derivatives markets; and introducing pre-trade transparency requirements for non-equity financial instruments traded on exchanges and MTFs;

3. transaction reporting—extending transaction reporting obligations to market members not authorised as investment firms; introducing a third trading capacity (client facilitation); requiring the collection of and defining standards for client and counterparty identifiers; and requiring the collection of client ID when orders are transmitted for execution; and

4. investor protection and intermediaries—introducing mandatory requirements for recording telephone conversations and electronic communications; requiring trading venues to produce reports demonstrating execution quality; clarifying the distinction between MiFID complex and non-complex financial instruments; clarifying the scope of the definition of investment advice; and harmonising the rules for the supervision of tied agents and related issues.

Read more.

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